

**Case No. D8/20**

**Salaries tax** – payments made after termination of employment – whether employment income – sections 8, 9 and 68(4) of the Inland Revenue Ordinance

Panel: Elaine Liu Yuk Ling (chairman), Carol Chan and Shi Shanshan.

Dates of Hearing: 4 and 5 December 2019.

Date of Decision: 21 September 2020.

On 18 July 2010, the Appellant was informed that his employment with the Company would be terminated.

As the Company was planning for its IPO in Hong Kong, the Appellant was asked to stay on gardening leave until the end of 2010.

The Appellant's employment with the Company officially ended on 14 January 2011.

Pursuant to an Agreement and Release signed on 27 January 2011, among others, three sums of payments ('Three Sums') were made to the Appellant:

- a 2010 incentive bonus payment in cash - US\$4,280,000 ('Sum A');
- a lump sum payment of pension matter - US\$520,000 ('Sum B');
- a lump sum payment of variance in stock valuation - US\$450,000 ('Sum C').

The Appellant contends that each of the Three Sums was not income from his employment and not chargeable to Salaries Tax.

**Held:**

1. The Three Sums were not paid to the Appellant to compensate for the abrogation of his pre-existing employment rights.
2. Each of the Three Sums are 'income from employment' or as an inducement to the Appellant for his continual serving as an employee between July 2010 and January 2011.

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- 2.1 Sum A - The Appellant was entitled to a performance bonus as a reward for his employment services in 2010.
- 2.2 Sum B - The amount was assessed and ascertained at the time when the Appellant was still in employment.
- 2.3 Sum C - The sum was the variance on the valuation of the stock salaries already paid to the Appellant.

**Appeal dismissed.**

Cases referred to:

Commissioner of Inland Revenue v Poon Cho-ming, John [2019] HKCFA 38  
Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74

Barrie Barlow, SC, instructed by MinterEllison LLP, for the Appellant  
Diana Cheung, Counsel, instructed by Department of Justice, for the Commissioner of Inland Revenue.

**Decision:**

**A. The Appeal**

1. The question in this appeal is whether three sums of payments ('Three Sums') made to the Appellant by his then employer are chargeable to Salaries Tax. By the Determination dated 28 May 2019 ('Determination'), the Deputy Commissioner decided that they are chargeable. The Appellant contended otherwise and he lodged this appeal against the Determination.

2. The Three Sums are:

- 2.1. Sum A: US\$4,280,000 (HK\$33,272,720), the 2010 incentive bonus paid to the Appellant.
- 2.2. Sum B: US\$520,000 (HK\$4,042,480), a lump sum payment in respect of a pension entitlement.
- 2.3. Sum C: US\$450,000 (HK\$3,498,300), a lump sum payment in respect of the variance in the stock valuation of shares options.

3. The Appellant set out the following grounds in his Notice of Appeal dated 24 June 2019:

- 3.1. Each of the Three Sums was not income from the Appellant's employment. They were paid in consideration of and for the purpose of securing the Appellant's consent to the termination of the employment, and his waiver of all actual or potential rights of action against his employer, as well as his forbearance from suing his employer for wrongful dismissal – through the 27 January 2011 Release Agreement (as defined below).
- 3.2. On 27 January 2011, the Appellant had no entitlement to claim payment of any of the sums under the Employment Letter (as defined below).
- 3.3. As confirmed by the 1 June 2018 decision of the Court of Appeal in Poon Cho-Ming, John v Commissioner of Inland Revenue (CACV 94/2016), the opinions of persons other than the parties to the Release Agreement as to the liability or otherwise of an employee's actual or potential rights of action for wrongful dismissal are irrelevant to the core issue, namely the purpose for which the payments were made.
- 3.4. Where there is an executed written termination contract (as with the Release Agreement here), the purpose for which a payment is made is to be gleaned from the executed contract itself (without reference to irrelevant parol evidence, such as proposed drafts).
- 3.5. None of the Three Sums was paid to the Appellant as an inducement or reward in relation to the period between 18 July 2010 when the Appellant received notice of termination, and 27 January 2011 when the Release Agreement was concluded and executed, and when the Appellant was on 'gardening leave'.

**B. Relevant Legal Principles**

4. Pursuant to section 68 of the Inland Revenue Ordinance ('the Ordinance'), the Appellant bears the onus of proving that the assessment appealed against is excessive or incorrect.

5. Section 8 of the Ordinance is the charging provision for Salaries Tax, which provides that income arising in or derived from Hong Kong from any office or employment of profit and any pension is chargeable to Salaries Tax.

6. '*Income from any office or employment*' is defined in section 9 of the Ordinance to include '*any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance, whether derived from the employer or others*'.

7. A payment received by an employee from his employer is not necessarily income 'from his employment' within the definition of section 9 of the Ordinance. (See: Fuchs v Commissioner of Inland Revenue (2011) 14 HKCFAR 74 at 81 [16])

8. Income chargeable under section 8(1) of the Ordinance is not confined to income earned in the course of employment but also embraces:

- 8.1. payment made ‘in return for acting as or being an employee’;
- 8.2. payment made ‘as a reward for past services’;
- 8.3. payment made ‘as an inducement to enter into employment and provide future services’.

[Fuchs [17]; Commissioner of Inland Revenue v Poon Cho-ming, John [2019] HKCFA 38 [14]]

9. In considering the nature of payment, one shall look at the substance, but not merely the form, and shall not be ‘blinded by some formulae which the parties may have used’. One is to look at the true purpose for which the payment was made, but not the parties’ characterisation of such payment. [Fuchs [17-18]]

10. In cases where payment was made to an employee when the employment is brought to an end, it will often be plausible for an employee to assert that the payment was made to compensate for his abrogation of his employment rights and argue that the payment was not subject to salaries tax. The Court of Final Appeal in Fuchs acknowledged this situation and held that to decide whether the above argument should be accepted, the operative test must be:

*‘In the light of the terms on which the taxpayer was employed and the circumstances of the termination, is the sum in substance “income from employment”? Was it paid in return for his acting as or being an employee? Was it an entitlement earned as a result of past services or an entitlement accorded to him as an inducement to enter into the employment? If the answer is “yes”, the sum is taxable and it matters not that it might linguistically be acceptable also to refer to it as “compensation for loss of office” or something similar. On the other hand, the amount is not taxable if on a proper analysis the answer is “No”. As the “abrogation” examples referred to above show, such a conclusion may be reached where the payment is not made pursuant to any entitlement under the employment contract but is made in consideration of the employee agreeing to surrender or forgo his pre-existing contractual rights.’* [Fuchs [22]]

11. The principles and approaches set out in Fuchs were confirmed by both the Court of Appeal and Court of Final Appeal in Poon. We respectfully adopted and applied these principles, and asked ourselves the question: in light of the terms of the Appellant’s employment and the circumstances of the termination, what is, in substance, the true purpose of the payment of each of the Three Sums.

**C. Facts**

***Agreed Facts***

12. By a Statement of Agreed Facts dated 19 November 2019, the parties agreed to the facts stated in Paragraph 1 (1) to (18) of the Determination which can be summarised as follows:

12.1. Company D is a public company with its shares listed in Country T. Company E ('the Company') and Company F were private companies incorporated in Hong Kong. Company F has become the immediate holding company of the Company since December 2009. Company D was the ultimate holding company of Company F and the Company until October 2010.

12.2. In October 2010, the shares of Company F were listed on The Stock Exchange of Hong Kong Limited. Following the listing, Company D's shareholding in Company F was significantly reduced.

12.3. By a letter of employment dated 15 September 2006 ('the Employment Letter'), the Company offered to employ the Appellant in Position G. The Employment Letter set out, among others, the following terms and conditions of employment:

12.3.1. Clause 1 – Effective Date

The effective date of the Appellant's employment would be as soon as the Appellant was officially released by Company H but no later than 1 January 2007.

12.3.2. Clause 2 – Base Salary

The Appellant's initial base salary would be US\$458,000, payable over 12 months.

12.3.3. Clause 3 – Bonus Plans

The Appellant would be eligible to participate in Division J Bonus Plan. The target bonus will be 60% of the Appellant's annual base salary for 2007 and 80% of the Appellant's annual base salary starting in 2008, with the potential to receive from 0 to 200% of the Appellant's target bonus depending on Division J performance and individual performance.

12.3.4. Clause 5 – Equity Compensation

(i) Stock Options

The Company would recommend to the Compensation Committee of the Board of Directors to grant options to the shares of Company D to the Appellant (Clause 5(a)).

(ii) Restricted Stock Unit ('RSU')

The Appellant would be eligible for RSU granted as a part of the annual compensation review process.

If the Appellant's employment was terminated by reasons other than voluntary resignation or summary dismissal or termination with cause, the grant for stock options and RSUs as committed to the Appellant but not yet due would be converted to cash equivalent based on the stock value at the date of his termination and form part of his termination settlement (clause 5(b))

12.3.5. Clause 10 – Probation and Notice of Termination

The probation period of the Appellant was waived. Either party could terminate the employment by giving three months written notice or payment in lieu of notice to other party.

12.3.6. Clause 12 – Retirement Benefits

(i) The Appellant would be eligible to join a Mandatory Provident Fund scheme as required by the Mandatory Provident Fund Schemes Ordinance.

(ii) The issue of the Appellant's pension with Company H would be addressed by the Company under a separate cover.

12.3.7. Clause 17 – Obligations

As the company's employee, the Appellant should obey the Code of Conduct ('the Code') as stipulated in the attachments and all terms in the Code of Conduct were made a part of the Employment Letter.

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- 12.4. The Appellant signed the Employment Letter on 19 September 2006 to signify his acceptance to the terms of his employment.
- 12.5. The Code contained, among others, that an employee of the Company must obtain written approval from his manager/department head before accepting outside employment.
- 12.6. The Non-solicitation and Non-disclosure agreement ('the Restrictive Agreement'), which was attached to the Employment Letter, contained, among others, the following terms and conditions:
  - 12.6.1. Clause 2

The Restrictive Agreement was a term and condition of the Appellant's employment with the Company.
  - 12.6.2. Clause 3

The Appellant agreed that during his employment and for one year after the termination of his employment, he would not directly or indirectly solicit the clients of the Company, Company D and their affiliates ('the Group') and solicit or provide assistance to the employees, consultant or agent of the Group to terminate their employment or other relationship with the Group.
- 12.7. The Appellant signed the Restrictive Agreement to signify his acceptance to the terms set out in the Restrictive Agreement.
- 12.8. The Appellant commenced his employment with the Company on 1 December 2006. He was appointed as Position K of the Company in 2009.
- 12.9. Pursuant to clause 3 of the Employment Letter, the Company advised the Appellant in its letter dated 7 June 2010 with a computation attached ('the Salary Review Letter') stating that the target of the incentive bonus for the year 2010 was US\$4,280,000, which would be payable to him in the forms of cash and stock in March of the year following the performance year.
- 12.10. On 18 July 2010, the Appellant was informed by Company D, on behalf of the Company, that his employment with the Company would be terminated and he was requested to stay with the Company until the end of 2010 for smooth transition.

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12.11. By an Agreement and Release signed on 27 January 2011 ('the Release Agreement'), the Company, Company D and the Appellant agreed, among others, the following terms and conditions:

12.11.1. Clause 1

The Appellant's employment with the Company would be ceased with effect from 14 January 2011 ('the Termination Date')

12.11.2. Clause 2

If the Appellant signed the Release Agreement and adhered to the obligations within it, the Company would make the following payments to the Appellant:

- (i) Accrued salaries for 1 January 2011 to the Termination Date - US\$93,333.33;
- (ii) Payment in lieu of 44.15 days of unused but accrued vacation leave - US\$161,524.39;
- (iii) a 2010 incentive bonus payment in cash - US\$4,280,000 ('Sum A');
- (iv) a lump sum severance payment - US\$309,246.53 ('SP');
- (v) a lump sum payment of pension matter raised by the Appellant - US\$520,000 ('Sum B');
- (vi) a lump sum payment of any variance in stock valuation affecting the calculation of other payments to be made to the Appellant as below - US\$450,000 ('Sum C').

(Sum A, Sum B and Sum C are collectively referred to as 'the Three Sums')

12.11.3. Clause 3

In accordance with the terms of the Employment Letter and the underlying plan documents, the Appellant would be paid:

- (i) his fully vested time-vested RSU as well as 475 additional as yet unvested time-vested RSU that



would be monetized in the amount of US\$25,650 ('Sum D');

- (ii) all fully vested RSUs that were granted to the Appellant under the Company D Restricted Stock Award Agreement in 2010 ('the 2010 Award'); and
- (iii) the Long-Term Performance Units, that the Appellant was awarded in 2010 pursuant to the Long-Term Performance Units Plan ('the 2010 Plan'), in the form of cash.

12.11.4. Clause 5

The Appellant waived and forever released and discharged all rights and claims he might have against the Group. The claims include without limitation, any claim for breach of contract, non-compliance with the employment laws of any jurisdiction, discrimination on any ground and any other breach of any contractual or statutory rights.

If the Appellant instituted or continued any proceedings for any claims, the Appellant agreed to repay to the Company within 30 days a sum equivalent to the payments set forth in Clauses 2 and 3 of the Release Agreement referred to hereinabove.

Other than the sums and benefits set forth in the Release Agreement, there were no other sums payable to the Appellant by the Group either pursuant to the statute or contract.

The Company waived any common law, statutory or other complaints claims charges or causes of action which the Company had or might have against the Appellant relating to actions or omission of the Appellant within the scope of his duties and responsibilities of the Company.

12.11.5. Clause 9

The Appellant agreed that for a period of six months after the Termination Date, he would not directly or indirectly solicit or participate in solicitation or recruitment of, or in any manner, encourage or provide assistance to any employees, consultant or agent of the Group to terminate their employment or other relationship with the Group.

12.11.6. Clause 13

The Release Agreement should be interpreted and enforced in accordance with the laws of Hong Kong.

12.12. The Company filed a ‘Notification by an employer of an employee who is about to ceased to be employed (‘the Notification’) in respect of the Appellant for the year of assessment 2010/11, which showed the following particulars:

(i) Period of employment : 01-04-2010 to 14-01-2011

(ii) Reason for cessation : Redundancy

(iii) Income particulars:

Salary & leave pay	\$10,087,511
Performance bonus	\$4,767,044
LTPU – The 2010 Plan	\$1,003,476
Others (included Sum D)	<u>\$274,098</u>
	\$16,132,129
RSU – The 2010 Award	<u>\$25,415,115</u>
Total	<u>\$41,547,244</u>

(iv) Place of residence provided for the period of 01-04-2010 to 14-01-2011 in the nature of a flat.

12.13. The Company stated that in addition to the above income, the Company paid HK\$43,217,551 to the Appellant upon his termination of employment, the breakdown of which was as follows:

	US\$
(i) Sum A	4,280,000
(ii) Sum B	520,000
(iii) Sum C	<u>450,000</u>
	5,250,000
(iv) SP (US\$900,000 / 12 x 4.123287 years)	<u>309,246</u>
	<u>5,559,246</u>

Converted at US\$1 = HK\$7.774

HK\$43,217,551

12.14. In the Tax Return – Individuals for the year of assessment 2010/11, the Appellant reported/claimed that:

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- 12.14.1. his assessable income from the Company was \$27,211,108, which comprised salary and others of \$16,132,129 (Paragraph 12.12 above) and RSU of \$11,078,979. Give the restriction imposed, only \$11,078,979 of RSU should be assessed to Salaries Tax in the year of assessment 2010/11;
- 12.14.2. rateable value of \$1,183,200 should be used to compute the value of place of residence provided by the Company; and
- 12.14.3. in addition to the income reported in Paragraph 12.14.1 above, he had received the Three Sums and the SP from the Company upon his termination of employment.
- 12.15. In accordance with the Appellant's tax return, the Assessor raised on the Appellant the following Salaries Tax Assessment for the year of assessment 2010/11 ('the Original Assessment')

	\$
Income per return	27,211,108
<u>Add: Rateable value (Paragraph 12.14.2)</u>	<u>1,183,200</u>
Assessable Income	28,394,308
<u>Less: Deductions</u>	<u>10,000</u>
Net Income	28,384,308
<u>Less: Allowances</u>	<u>366,000</u>
Net Chargeable Income	<u>28,018,308</u>
Tax Payable thereon (at standard rate)	<u>4,251,646</u>

- 12.16. The Appellant did not object to the above Original Assessment which then had become final and conclusive in terms of section 70 of the Ordinance.
- 12.17. On divers dates, the Company filed the following three more Notifications in respect of the Appellant reporting additional incomes accrued to him:

Date of Notification	<u>08-05-2012</u>	<u>14-05-2013</u>	<u>07-11-2013</u>	<u>Total</u>
Income – LTPU (The 2010 Plan)	\$1,656,220	\$3,351,949	\$10,820,850	\$15,829,019

- 12.18. Upon reviewing the Appellant's Salaries Tax liabilities for the year of assessment 2010/11, the Assessor did not accept the Appellant's computation of the assessable amount of RSU. The Assessor considered that the assessable amount of RSU, after discount was given to reflect the restriction imposed, should be \$23,789,475. On

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this basis and to take into account the additional income reported by the Company in the Paragraph 12.17 above, the Assessor raised the following Additional Salaries Tax Assessment for the year of assessment 2010/11 ('1<sup>st</sup> Additional Assessment'):

	\$
RSU under assessed (\$23,789,475 - \$11,078,979 (Paragraph 12.14.1))	12,710,496
LTPU reported (Paragraph 12.17)	<u>15,829,019</u>
Additional Net Income	<u>28,539,515</u>
Tax Payable thereon (at standard rate)	<u>4,280,927</u>

12.19. The Assessor requested the Appellant to provide information about the payment of the Three Sums and the SP.

12.20. Ernst & Young Tax Services Limited ('EY'), on behalf of the Appellant, objected to the 1<sup>st</sup> Additional Assessment on the ground that it was excessive. After several exchanges of correspondence, the Appellant withdrew his objection to the 1<sup>st</sup> Additional Assessment.

12.21. In response to the Assessor's enquiry stated in Paragraph 12.19, the Appellant, through Messrs Deloitte Touche Tohmatsu ('the Firm') claimed that the Three Sums and the SP were not paid for his services rendered to the Company but for his agreement to waive all the claims against the Company and thus should not be chargeable to Salaries Tax.

12.22. The Assessor accepted the Appellant's claim for exemption of the SP but not the Three Sums. Besides, she considered that Sum D, which had not yet been assessed before, should also be assessable to Salaries Tax. The Assessor raised on the Appellant the following second Additional Salaries Tax Assessment for the year of assessment 2010/11 ('2<sup>nd</sup> Additional Assessment')

	\$
The Three Sums (US\$5,250,000 @7.774) (Paragraph 12.13)	40,813,500
<u>Add: Sum D (US\$25,650 @7.774) (Paragraph 12.11.3(i))</u>	<u>199,403</u>
Additional Net Income	<u>41,012,903</u>
Tax Payable thereon (at standard rate)	<u>6,151,935</u>

12.23. The Firm, on behalf of the Appellant, objected to the 2<sup>nd</sup> Additional Assessment on the following grounds:

12.23.1. The Three Sums were compensation payments made to the Appellant and should not be chargeable to Salaries Tax.

12.23.2. Sum D had already been assessed under the Original Assessment and should not be assessed again.

13. It is not in dispute that the Assessor agreed that Sum D had already been assessed in the Original Assessment. The scope of the present appeal is on the taxability of the Three Sums.

***Oral testimony***

14. In addition to the above agreed facts, the Appellant has adduced a statement dated 5 January 2018 and testified at the hearing before the Board. We have carefully considered the Appellant's evidence, and found that the Appellant has a tendency of steering his evidence to suit his own case. The effect of his evidence to this appeal was analysed below.

15. The Appellant has also provided a statement dated 18 December 2017 from Ms L. Ms L was the Position M and Position N of the Company from January 2010 to April 2011. She was not involved in the settlement negotiations between the Appellant and the Company. She was not called by the Appellant to give oral evidence at the hearing and the contents of her statement was not tested by cross-examination. We found that her evidence is of very limited assistance.

**D. Decision**

16. The Three Sums were payments made after the effective termination of the Appellant's employment, and were stated as part of the payments made under the Release Agreement. Nonetheless, as held in Fuchs and Poon, these payments will be subject to the Salaries Tax if their true purpose are income from the employment.

17. The Appellant put forward as one of his grounds of appeal a proposition that where there is a written termination (the Release Agreement in the present case), the purpose for which a payment was made is to be gleaned from the Release Agreement itself (See paragraph 3.4 above). This proposition is in contradiction with the decision of Fuchs.

18. As enunciated by the Court of Final Appeal in Fuchs and confirmed in Poon, determination of the substance and true purpose of the payment in question shall not be blinded by the formulae used by the parties or the parties' characterisation of these payments. The purpose of the payments shall be considered '*in light of the terms on which the taxpayer was employed and the circumstances of the termination*' [Fuchs [22]]

19. The Appellant's counsel also accepted in his submission that in ascertaining the purpose of any contractual payment made by an employer, it is relevant to consider, among others, the circumstances existing at the time the payment was made.

20. We did not agree that this Board should only consider the terms of the Release Agreement when identifying the purpose of the payment in question.

*Circumstances of the termination of the employment*

21. The Appellant's evidence was that he had a meeting on 18 July 2010 in Hong Kong with Mr P, the then Position U and Position K of Company D. During the meeting, he was informed that he was to be terminated and would be replaced immediately by Mr Q with immediate effect. Mr Q was ready to assume the office as the new Position K when Mr P informed the Appellant of the decision to dismiss him.

22. As the Company was planning for its IPO in Hong Kong (which was aimed to complete by the end of 2010), the Appellant was asked to stay on gardening leave at the Company until the end of 2010. The Appellant's role during the remaining period at the Company was of a transitional nature. He did not perform any usual duties at that period and had a separate office outside the main office of the Company.

23. Mr P also said at the meeting that if the Appellant remained in the employment of the Company until the end of 2010, co-operated with the Company during the IPO period and had a smooth transition of his role to Mr Q, the Appellant would receive the 2010 Incentive Performance bonus in full.

24. The Appellant said he was kept on in a capacity (by continuing paying his monthly salary) to stop him from disrupting the business of the Company.

25. The Appellant said that he did not have any non-compete clauses in his employment agreement. However, this was contradicted by the documentation, which we elaborated below.

26. On or around the same date (i.e. 18 July 2010), the Company made a public announcement about the Appellant's departure, stating that he would be leaving the Company 'to pursue other opportunities' at the end of the year. It was also stated in the Company's internal announcement dated 19 July 2010 that the Appellant would work closely with Mr Q to support a smooth transition. The Appellant said that this was contrary to the reality. He did not voluntarily resign. He was dismissed. The reason for the termination of his employment was the differences on the direction and strategy of the Company's development.

27. The Appellant has completed his 'gardening leave'. His employment with the Company officially ended on 14 January 2011. During this period, the Appellant remained to be on the Company's payroll and received full salary, annual leave and other entitlements under the Employment Letter until 14 January 2011.

28. In about December 2010 and January 2011, there were negotiations between the Appellant and the Company, through their respective solicitors.

29. By an email from the Appellant to Mr Q on 14 January 2011 (the last date of the Appellant's employment with the Company), the Appellant recorded the agreement with Mr Q on the termination payments, which include Sum A, Sum B and Sum C. It was expected that a formal agreement would be signed by the parties.

30. The Release Agreement was signed on 27 January 2011. The payments (including Sums A to C) were paid to the Appellant after the execution of the Release Agreement.

***Non-compete and non-solicitation obligations (Restrictive Agreement)***

31. The Appellant said that he was not subject to any non-compete or non-solicitation restrictions upon the termination of his employment with the Company.

32. Paragraph 17 (d) of the Employment Letter provided that the Appellant shall obey the Code of Conduct, and all terms in the Code are made a part of the agreement in the Employment Letter. It is an express term in the Code of Conduct that an employee planning to leave the Company may not solicit or encourage another employee of the Company to leave the employment of the Company. The Appellant accepted in cross-examination that he was bound by the provisions in the Code.

33. Further, there was a Non-Solicitation and Non-Disclosure Agreement ('Restrictive Agreement') signed by the Appellant and the Company, which contains, among others, the following terms:

33.1. Under Clause 2, it was expressly stated that employment with the Company is conditional upon the Appellant's execution of the Restrictive Agreement, which is a term and condition of the Appellant's employment with the Company.

33.2. Under Clause 3, there was an agreement not to solicit directly or indirectly any customers or clients or prospective customer or client of the Company during his employment with the Company and for a period of one year after termination of the employment for any reason.

34. It is an agreed fact that the Restrictive Agreement was attached to the Employment Letter (see Paragraph 12.6 above).

35. At cross-examination, the Appellant confirmed that the signature on the Restrictive Agreement was his. He did not recall he had signed it and when it was signed, but he said 'So it was clearly signed some time in that four years, but I don't recall when that was, which is a bit strange because it's just not signed.' He was in employment with the Company for about four years. When he was asked to confirm that the Restrictive Agreement was signed during his employment with the Company, the Appellant said he did not know because it was too long ago for him to be precise. He immediately offered a guess that it was possible that the Restrictive Agreement was signed as part of the termination agreement.

36. There is no logical basis to support the ‘guess’ that the Appellant offered, and such ‘guess’ falls foul of common sense.

36.1. The terms of the Restrictive Agreement clearly showed that it was an agreement signed when the Appellant ‘is or soon to be’ an employee of the Company. It was not signed in anticipation of a termination of the employment.

36.2. The Release Agreement has already contained terms restricting the Appellant from soliciting or communicating with the Company’s employees or agent to leave the employment with the Company for a period of 6 months after the termination (Clause 9). There was also a provision in the Release Agreement restricting the Appellant from disclosing confidential information of the Company. If it was intended to include as part of the termination agreement a restriction from soliciting customers after termination (as contained in the Restrictive Agreement), the Company could simply insert a similar term in the Release Agreement instead of requiring the Appellant to sign the Restrictive Agreement as a condition for the employment.

37. We did not speculate as to why the Appellant chose to offer this ‘guess’. We rejected the suggestion that the Restrictive Agreement was signed as part of the termination agreement. The Appellant accepted that the signature on the Restrictive Agreement was his. The inference to be drawn was that the Restrictive Agreement was executed either before or during the Appellant’s employment with the Company.

38. The Appellant further said that he was advised by Tanner De Witt that because ‘it wasn’t dated, it was probably not valid, and particularly given I was terminated.’

39. We did not agree that an agreement would become invalid because it was undated. Neither do we accept that the termination of the employment would necessarily invalidate the Restrictive Agreement.

***No abrogation of rights***

40. It is the Appellant’s case that the Three Sums were paid for the purposes of securing the Appellant’s consent to the termination of the employment, his waiver of rights of action against the Company; and his forbearance from suing the Company for wrongful dismissal. (see the Appellant’s grounds of appeal set out in paragraph 3.1 above)

41. Pursuant to Clause 10 of the Employment Letter, the Company has the right to terminate the employment with the Appellant by giving three months’ notice or payment in lieu of notice. Under the Employment Letter, the Company was not required to secure the Appellant’s consent to the termination of the employment.



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42. The Appellant was given notice of termination at the meeting with Mr P on 18 July 2010 followed by public announcement of the Appellant's leaving on the same or following day. Thereafter, the Appellant stayed with the Company on 'gardening leave' for about 6 months with full pay of salary and benefits under the employment. There was more than 3 months' notice given.

43. The Appellant stated in his witness statement that he threatened to commence legal action against Company D and the Company for wrongful dismissal. However, no particulars were given.

44. Even in all the correspondences between the Appellant's lawyers and the Company's lawyers when they were negotiating for the payments, there was no mention of legal action or any threats of litigation at all.

45. The Appellant said in examination in chief that after the meeting with Mr P, he had numerous discussions with Mr R on compensation. He first threatened to sue 'when it was clear at that stage that they thought they weren't going to pay me anything'. He also said that it happened on many occasions thereafter. But he could not remember the dates.

46. Upon being further asked by the Board, the Appellant said that he did not threaten to sue at the first meeting with Mr P as it was a big surprise to him. He said to Mr R 'sue your ass' at a telephone conversation a few weeks later. The Appellant did not tell us any further particulars about this conversation with Mr R. When the Board asked the Appellant for the reason of not including this conversation in his witness statement, the Appellant said there was no reason.

47. The Appellant then said that his emails with Mr Q shown he had made the threats to sue for wrongful dismissal. There were no such emails before the Board. We note that in an email from the Appellant to Mr Q dated 18 January 2011, it was stated that 'This note is to confirm that I would not take action against [Company E] for few days delay in the payment of the agreed termination payments.' This was made after the Appellant had confirmed with Mr Q the termination payments. The action referred to in the email was for 'a few days delay in the payment' of the agreed sums, but not on wrongful dismissal or loss of office as the Appellant had suggested.

48. In about December 2010, the Appellant instructed Tanner De Witt to issue an open letter to the Company, setting out the Appellant's entitlement to various payments, including Sum A and Sum B. There were then several correspondences between Tanner De Witt and the Company's solicitors Paul Hastings. As stated above, there was no mention of threats to sue for wrongful dismissal or loss of office in these correspondences. We did not accept the Appellant's argument that the label of 'without prejudice' on some of the correspondences circulating the draft Release Agreement proved that the Appellant had threatened to sue for wrongful dismissal.

49. For completeness, we should also mention EY's letter dated 3 December 2014 made in answer to the Revenue's enquiries. In that letter, EY stated that 'Due to

sudden removal from office, which was unexpected, [Mr S] started action against [Company D] and [Company E] to seek damages against the companies for loss of office and resultant monetary loss. The parties ([Company D], [Company E] and [Mr S]) agreed to negotiate a settlement in respect of the damages claim. [Mr S] was represented by Messrs. Tanner De Witt (“TDW”) and [Company D/Company E] were jointly represented by Messrs. Paul Hastings, Janofsky & Walker (“PH”)’.

50. There was simply no evidence in support of the above bald assertion that the Appellant started action against the Company for loss of office and resultant monetary loss.

***Purposes of the Three Sums***

51. The Board should consider each of the Three Sums individually, determine the true purposes of these payments and whether, in substance, they were ‘income from employment’ or for ‘something else’.

52. By reason of our analysis below, our answers were that each of the Three Sums are ‘income from employment’, they are payments made pursuant to the terms of the Employment Letter or as an inducement to the Appellant for his continual serving as an employee between July 2010 and January 2011.

***Sum A***

53. Sum A (US\$4.28 million) is a 2010 incentive bonus paid to the Appellant in cash (See Clause 2(c) of the Release Agreement).

54. In addition to a fixed pay, the Appellant’s 2010 package comprised a component of variable annual pay which was the proposed amount of performance bonus that could be awarded at target. This variable annual pay consisted of two components: variable cash and variable stock.

55. It was the Appellant’s own evidence that the 2010 proposal at target for variable cash and variable stock respectively was in the amount of US\$2.14 million each (thus a total of US\$4.28 million) to be awarded to the Appellant subject to performance in March of the year following the performance year (that is 2011).

56. By a letter dated 7 June 2010 from Ms L, the then Position N of the Company to the Appellant (i.e. the Salary Review Letter), the Appellant was informed that the relevant committee of the Company D Board has confirmed the Appellant’s 2010 package. There is no dispute that this referred to the performance bonus, that is Sum A (US\$4.28 million). The full terms of the letter are as follows:

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‘Dear [the Appellant]

Please be advised that the Compensation and Management Resources Committee of the [Company D] Board has met and confirmed your 2010 package end of May.

For detail, please refer to the attached communication and worksheet from Mr R, Head of Human Resources, [Company D], sent to you on April 27, 2010.

The package will be retroactive January 1, 2010. We will process all back pay as soon as possible.’

57. It is clear from the above Salary Review Letter that the Committee of the Company’s Board has confirmed the Appellant’s 2010 package<sup>1</sup> which was effective retrospectively from 1 January 2010.

58. In the witness statement, the Appellant said that the entitlement of the above sum was subject to the fulfilment of the performance targets for the financial year 2010.

59. At cross-examination, the Appellant repeatedly said that the actual payment of the bonus was discretionary, and was not only dependent on the fulfilment of the performance target. However, the Appellant failed to explain the basis on which the Company retained a discretion for payment of the bonus even if the performance target was reached. The Appellant did not explain why he did not mention such ‘discretion’ in the witness statement.

60. The Appellant’s oral evidence was also different from the contents of Tanner De Witt’s letter written prior to the termination of employment, in which it was stated that the performance target was met by 30 November 2010, and the Appellant was entitled to the performance bonus, i.e. Sum A.

61. The relevant part of Tanner De Witt’s letter dated 6 December 2010 was as follows:

‘We are further instructed that [Company E]’s financial year ended on 30 November 2010 and that our Client [the Appellant] has met and exceeded all performance targets set for our Client and [Company E]. We note in this respect that [Company E] was successfully listed on the Hong Kong Stock Exchange in October 2010 and ...

In the circumstances, our Client expects to be paid (at a minimum) his full 2010 Incentive Award of US\$4,280,000 in cash upon termination of his employment. This award entitlement should be paid in cash because any stock awarded by way of annual compensation but not yet due would need

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<sup>1</sup> There is no dispute that this package referred to the performance bonus, i.e. Sum A.

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to be paid out in cash in any event under clause 5(b) of his Contract [Employment Letter] (see below).’

62. Paul Hastings, the Company’s solicitors, did not dispute the above statement about the fulfilment of the Appellant’s performance targets.

63. We did not accept the Appellant’s oral evidence that the Company retained a discretion on the payment in addition to the fulfilment of the performance target.

64. We came to the view that the Appellant was entitled to a performance bonus as a reward for his employment services in 2010. The Salary Review Letter confirmed that the Company approved the target and the amount of the bonus to be paid to the Appellant if the target was met. As shown from Tanner De Witt’s letter written on instruction of the Appellant, by 30 November 2010, the performance of the Company exceeded all performance targets. We did not accept the Appellant’s assertion at the oral testimony that the contents in Tanner De Witt’s letters were mere negotiating position and should not be relied on. It is of note that this statement was not disputed by the Company.

65. Furthermore, in light of what Mr P had said at the meeting on 18 July 2010 about the payment of full performance bonus to the Appellant if he remained in employment until the end of 2010, acted in cooperation with the Company during the IPO period and had a smooth transition of his role to Mr Q, all of which the Appellant had done, Sum A was also a payment to reward the Appellant to remain in employment during the period from 18 July 2010 and until the final termination date.

66. We found that Sum A is chargeable to Salaries Tax.

***Sum B***

67. Prior to the Appellant’s joining the Company in 2006, he was the Position K of Company H, and was entitled to a pension. This pension was forfeited when he left Company H and joined the Company.

68. In Clause 12 of the Employment Letter, it was expressly provided that:

‘The issue on [the Appellant’s] pension scheme with [Company H] will be addressed under separate cover subject to [the Appellant’s] submission of written documentation with all the scheme details.’

69. Clause 12 was a term of the employment made to induce the Appellant to provide employment services with the Company.

70. It was not in dispute that the Appellant had submitted the documentation according to Clause 12 and the pension amount was assessed at a value of US\$520,000.

71. Tanner De Witt’s letter dated 6 December 2010 stated that the Appellant was entitled to Sum B pursuant to Clause 12 of the Employment Letter and the collateral

agreement that the Appellant was to be reimbursed the sum equivalent to his pension entitlement prior to his departure from Company H. Tanner De Witt also stated in its letter that the Appellant was contractually entitled to this sum and he had received a number of assurances from the Company that this sum would be paid. To substantiate this statement, Tanner De Witt referred to the Appellant's respective conversations with Mr R and Mr Q, and corroborating contemporaneous correspondences with various representatives of the Company supporting the Company's commitment to pay the sum.

72. At the hearing, the Appellant again dismissed the statement in Tanner De Witt's letter as a negotiating position. He also pointed out that although the Company agreed to pay the sum, it denied it has a legal obligation to make the payment (see Paul Hastings' letter dated 13 January 2011).

73. The Appellant also argued that Clause 12 of the Employment Letter only addressed the possibility of paying the Appellant the pension sum. It was not an accrued right entitled to the Appellant prior to the execution of the Release Agreement.

74. We did not accept the Appellant's oral testimony that Tanner De Witt's statements were a mere negotiating position which could not be relied on. There was no reason to suggest that Tanner De Witt would make up stories in its letter.

75. We found that Sum B was made pursuant to Clause 12 of the Employment Letter. The amount was assessed and ascertained at the time when the Appellant was still in employment. It was an income from the Appellant's employment with the Company and is taxable.

### ***Sum C***

76. Sum C is a payment representing the variance of valuation of stock (including RSU and LTU) entitlement under the Employment Letter. These stock salaries were paid to the Appellant during his employment and were duly reported by him as employment income. The Appellant had paid tax thereon.

77. The payment of Sum C is the variance on the valuation of the stock salaries already paid to the Appellant, but not with respect to the granting or vesting of any stock units to the Appellant after the employment. The obligation under the Employment Letter was to pay the Appellant the stock salaries. It must mean that the Company shall pay the correct valuation as adjusted. We found that Sum C was an income from the Appellant's employment service.

### **E. Disposition**

78. By reasons of the above, we dismissed the appeal and confirmed the Determination.